

Apple's Next Move?

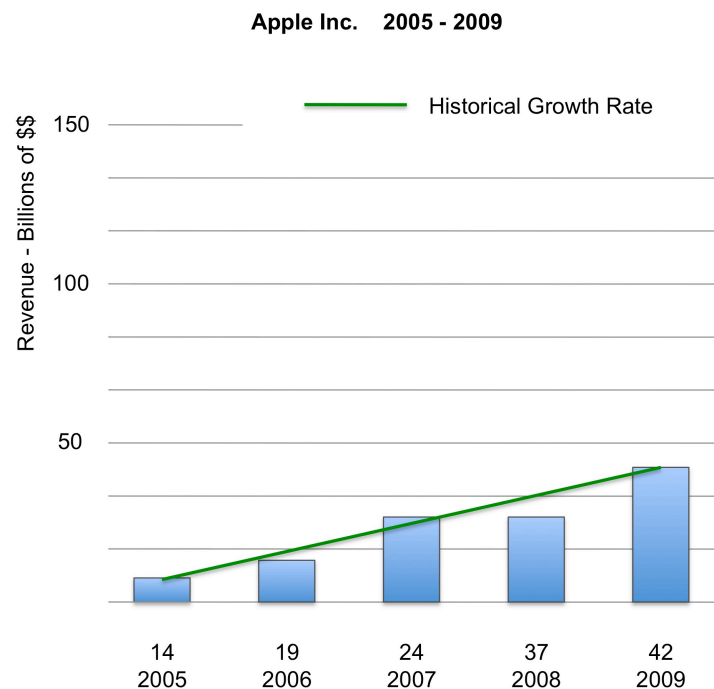
By Langdon Morris

I had been gathering my thoughts for a blog post about the future of Apple when the sad news came out that Steve Jobs has taken another leave of absence due to his medical problems. It's a shame to see a person at the height of his creative powers sidetracked by health concerns, and one can only wish him well.

The company he leads has grown magnificently since he returned as CEO in 1997, passing arch-rival Microsoft to become one of the most highly valued companies in the world. But remaining in the pantheon will require considerable skill as well as perhaps a good dose of good luck, because doubling in size when you're a \$6 billion company is a lot easier to do than your sales have grown to \$60 billion.

So with or without Steve Jobs, Apple faces significant challenges in the coming years, and the major themes about the future of the various industries in which it competes offer a lot to think about. So what are Apple's best strategic options? My goal here is to see if we can come up with a decent picture of Apple's future...

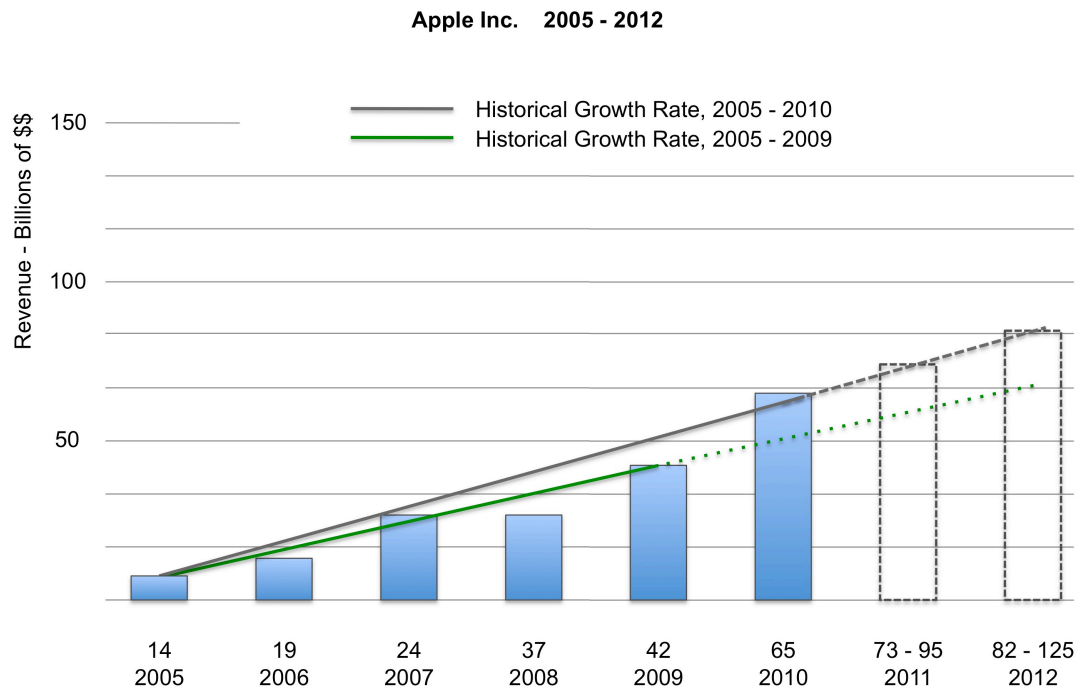
First of all, let's look at revenue growth to get a sense of how the game is changing.



As you see, revenue growth was admirably steady from 2005 – 2009. This encompasses the period of Apple’s total dominance of the MP3 market through the introduction of the phenomenally successful iPhone in 2007, and then iPhone’s steady sales growth.

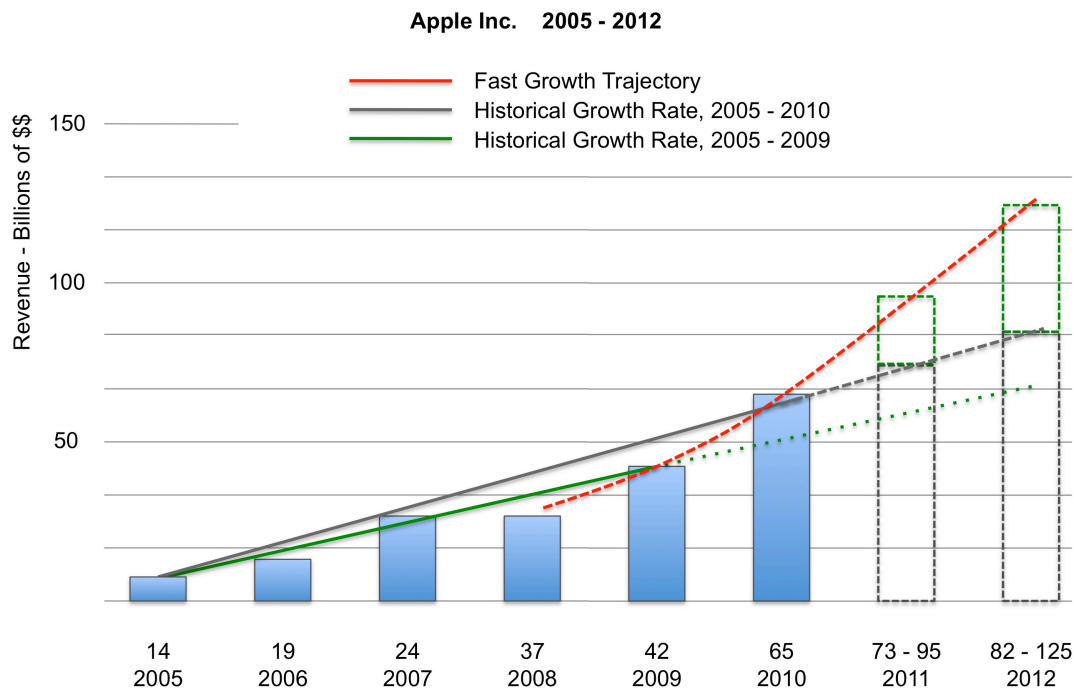
2010, however saw a dramatic change in the trajectory. The jump in revenue from 2009 to 2010 was so great that a new, higher historical growth trend line replaces the trend line from 2005 – 2009.

The question for investors is whether Apple can continue to grow along the accelerating vector that’s suggested by the red line, which would indeed justify the huge market capitalization that Apple now enjoys.



Conversely, if Apple cannot sustain the accelerated growth, then it seems highly unlikely that the company will continue to enjoy its current market cap.

The question, therefore, is something along the lines of, What will take for Apple to sustain its current momentum?



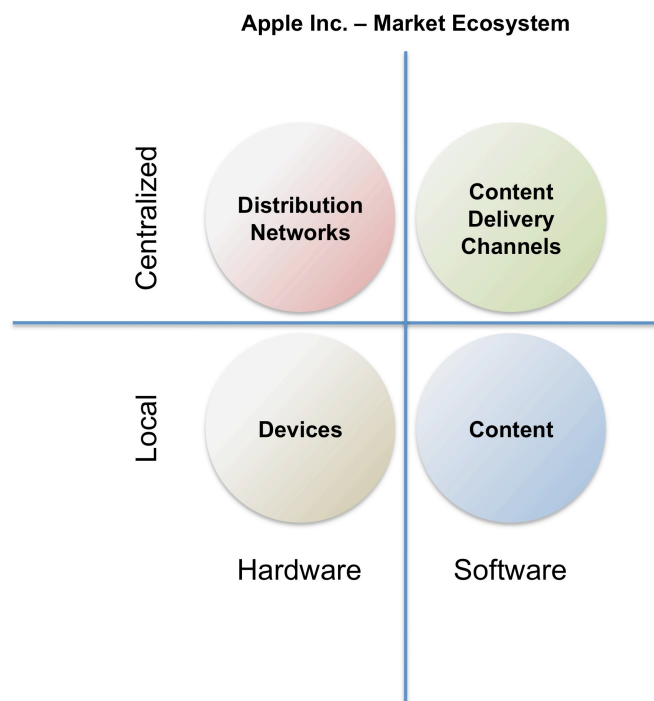
Apple's Market Ecosystem

The first order of business in examining which future is most plausible is to identify and explore what we call a “strategic framework,” a way to think about Apple and the markets in which it competes that may offer some insight into the future.

One view of Apple's market ecosystem says it has four major components: devices, distribution networks, delivery channels, and content. These four markets can be further distinguished between hardware and software, and between devices and content that are local to the user or producer, or which are based on networks that reside centrally. All of these elements are evident in the following matrix.

1. **Devices;** hardware and locally distributed – These are the end user devices, computers, iPods, phones and pads. Apple makes these. Over the last decade the company has evolved from a device maker narrowly defined as a computer company with a handful of products, to one with a much broader portfolio across the iFamily of devices. To reflect this shift the company removed the word “computer” from its official corporate name – now it's just “Apple, Inc.” not “Apple Computer.”

2. **Distribution networks;** hardware and centralized – These are the wireless phone networks that connect the devices that Apple makes. These networks are created and run by Apple’s partners, including AT&T, Verizon, etc..
3. **Content creators;** software and locally distributed – These are the individuals and organizations that record the songs and create the TV shows and movies that you buy on iTunes, and write the apps you use on your phones.
4. **Distribution platforms and channels;** software and centralized – Apple has proven itself as a skilled distributor as a retailer, the proprietor of the world’s most successful chain of stores, now numbering more than 300, and as an e-tailer, proprietor of iTunes and Apps.



The company depends for its success on the integration of all of these elements into a functional device + network + content creation + content delivery system, which is a market ecosystem of no small complexity.

The validity of this ecosystem principle is strongly reinforced in the following comment from the new CEO of Nokia, Stephen Elop. In discussing Nokia’s new alliance with Microsoft, he said, “The game has changed from a battle of devices to a war of ecosystems.”

The fact that Apple recognized this dynamic earlier than its competitors – especially Nokia – has contributed significantly to its success. And the risks associated with *not* managing the entire ecosystem is fully evident in Nokia's precipitous decline of the last few years from the world's leading cell phone maker, to a company in danger of being left behind, out-innovated, made irrelevant by the rapid evolution of the market.

Some of these elements of the ecosystem include markets that Apple has influence over, some that it controls outright (such as the iTunes and App stores), and some for which relies on partners. Each has unique characteristics, factors and attributes that could make it highly appealing or less attractive for the future.

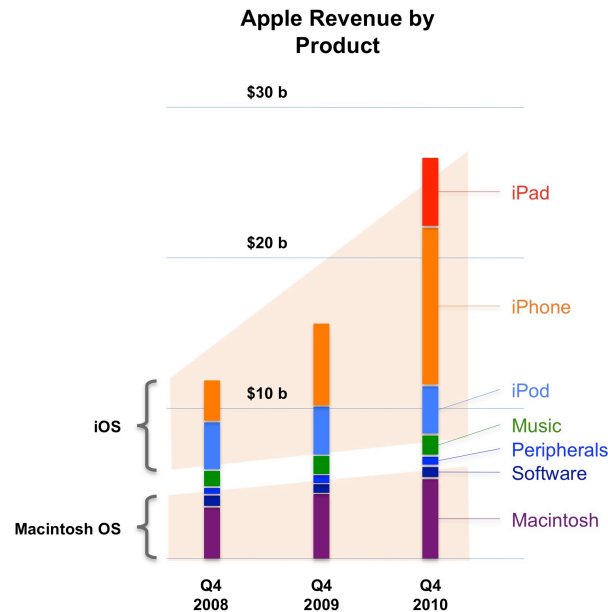
Devices – What new devices could Apple create that offer significant growth potential? Are there more computers, pods, pads, phones and other yet-unrevealed devices waiting, more multi-million selling device rabbits in the hat? Or perhaps Apple's near the end of the line?

What do we see in devices? After Apple introduced the iPhone in 2007, Google quickly copied many of the iPhone's best attributes with Android, which came out in 2008. By 2010 Android phones, with global distribution through multiple handset manufacturers, were outselling iPhones worldwide, showing that there's still some strategic value in the fast follower strategy as practiced by Google. With Android competition has also come dramatically lower prices – now you can get an iPhone for \$49, a steep discount off the \$199 it would have cost you a year ago.

Will Apple's initial lead in iPads also shrink? With competitors coming from everywhere, there are certainly many manufacturers who want to lead the tablet market, but so far Apple's mastery of the entire ecosystem has enabled it to dominate.

So does the device market offer Apple the growth it's looking for? Since Apple's approach to the user interface has become the worldwide standard for phone, pad, and computer design, commodity dynamics will only intensify since these design principles can be readily copied, which will in turn make these markets less and less attractive to a company that built its success on high margin differentiation.

But the following graph tells the story somewhat differently.



As you see, from Q4 2008 to Q4 2010, the growth in revenue from Apple products that use its mobile operating system, iOS, has been far faster than the growth from the Macintosh OS. I believe that this tells us that Apple is, in effect, trapped by its own success with iOS, and that iOS must be the driver for its future growth.

So the way forward for the company must be to continue to expand the appeal of its mobile iOS devices, which means that Apple will have to continue to develop a broad range of products.

If the iPhone and iPad are “high end” devices with impressive market share, then the market segment that remains as yet untapped would be that for lower cost smart mobile devices, in other words, a smaller, cheaper iPhone.

Such an Apple device would put it into direct competition with companies like Nokia, Samsung, and LG. It would also be in competition with the inevitable Android entry into that

category, and in fact, it may be because Android will go to a cheaper and smaller handset that Apple will be obliged to do it as well.

It's most likely that Apple would then attempt to entice its new cheap-phone customers to move up to more powerful – and more expensive – devices, including most powerful phones and perhaps new versions of pads as well.

Are there other iOS markets that the company could also exploit?

Perhaps Apple will consider the car as an attractive telecommunications and media platform. An iCar wouldn't sell in the volumes that iPhones do, but isn't it enticing to imagine a Tesla car with a build-in iSuite? That would be off the charts as far as cool factor goes. And even a Toyota wouldn't be too bad.

And certainly Apple will continue to try to develop its market in the home, with a more robust iHome. There's much more to be done here than the company has so far succeeded with.

Distribution networks – If Apple wants to avoid commodity markets, then it will probably want nothing to do with the business that AT&T, Verizon, and all the world's other operators compete in. In this market not only are price-competitive dynamics the norm, but the cost to build the necessary wireless infrastructure is only increasing, and margins will be the casualty.

Content – Does Apple want to own content creators? This is a business that Steve Jobs knows intimately, having developed Pixar into a global animation paragon, and then sold it for a fabulous sum to Disney, one of the world's great proprietors of branded content (becoming Disney's largest shareholder in the process). But is content right for Apple? So far the company's been able to leverage content created by others, and there's nothing to suggest that the company wants to get into content now. It makes much more sense for Apple to provide a platform for content created by others than to venture into this risky world.

Distribution platforms and channels – Will Apple expand its tunes and apps distribution efforts? Almost certainly this business holds great promise for Apple's future because the value of its mobile devices is directly related to the depth of apps that are available in the App store. New areas to explore include the development of a subscription model for app and app-related content to complement the transaction-oriented approach it currently employs.

So are there are acquisition targets in that future, or will this business grow organically without the need for vast sums of capital? With millions of end user devices waiting to be supplied with music, entertainment, and news, there are abundant opportunities to expand its distribution opportunities.

Perhaps even more lucrative than these forms of content is the domain of advertising, and if Apple can define a gateway between a large base of end users and the advertisers who always want to reach them; the company has only to take a look to the north up Silicon Valley's Highway 85 to see what Google's done with its immensely lucrative revenue stream as the world's leading ad agency. Yes, this is a channel with a future.

So there are some interesting possibilities here, and certainly there must be business units at Apple which are developing the company's efforts in all of these markets.

End User Markets

There's another way to visualize Apple's options, in this case not by looking at the ecosystem of providers, but at various customer groups.

As an iconoclast brand that largely defined itself through its ad campaign to "Think Different," Apple has traditionally marketed itself to individuals who embraced its vision.

And having defined the global standard for smart phones and tablets, Apple's brand identity is now closely tied to its mobile users.

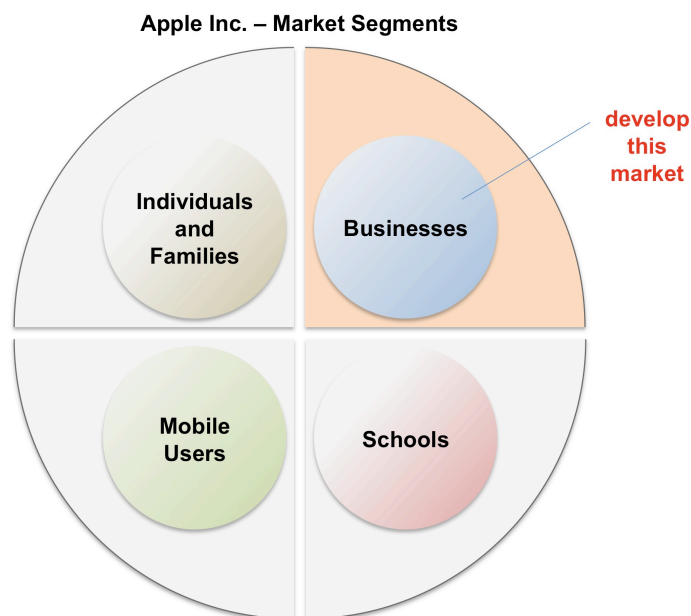
Its brand is also linked with the e-distribution model of iTunes and Apps, and in the home market, the emerging competition with Netflix and the other streaming video services promises to be an interesting ride.

The company's computers are also strong sellers in the schools market.

But to continue to grow, and particularly to accelerate growth of its traditional computers, Apple may also need to expand its presence in the business market, where Microsoft built its wealth-building global franchise as the operating system and software suite of choice for corporate IT departments. Windows and Office have been locked in as the preferred software platforms for the past 2 decades, but what would it take for Apple to take a more significant share of the business (or enterprise) market?

Mandatory tools would include a complete IT toolset, consisting of unimpregnable firewalls, secure data solutions for mobile users, integration between mobile devices and laptops, scalable servers A few years ago Oracle gobbled up Sun Microsystems, but it's interesting to speculate what Apple might have been able to accomplish with Sun as its enterprise arm. The engineering challenges of integrating the technology platforms of the two companies would have been overwhelming, if not impossible, but in concept this is the sort of move that may still be required for Apple to establish a meaningful presence in the enterprise market.

And perhaps the Trojan horse that can motivate this shift will be the iOS devices, the iPhone and iPad, which have attracted widespread corporate users even in companies where Microsoft and Blackberry were standardized solutions. If Apple can convince IT departments that its solutions really do address their privacy and security concerns, then perhaps the need of phone and pad users to sync with their laptops can be leveraged into significant market growth.



What's Your Move?

Now suppose that you're the person designated to replace Steve Jobs, or at least to advise him, and you have to choose which markets to pursue.

Keep in mind that over the last few years Apple has accumulated a monumental hoard of more than \$58 billion in cash. The company has made modest acquisitions over the last few years, but sooner or later it will have to either spend its money by making some blockbuster acquisitions, or return the cash to its shareholders in the form of dividends. So what would you choose to do with Apple's \$58 billion? Can you find some way to invest it? (It's not that easy to do.)

Being an innovation strategist, you'd know that it's not wise to bet on a single strategy, and in fact you know that the diversification of the company from its core computer market into entertainment devices and communications devices, and the markets that support them, has been a key element of the company's growth and success.

You also know that the company must develop an ever-larger innovation portfolio to provide the basis for its future growth. Here are six major opportunities.

Apple's revenue chart shows that the growth of the iOS is the key to the company's short term success, and five of these six opportunities are iOS based.

iOS growth opportunities

- Apple is interested in new markets where it can own recurring, subscriber-based revenue streams. The technology that calls out here is video streaming, and Apple is already targeting the home market, where it competes with Netflix. But in a convenient demonstration of the complexity of this market ecosystem, Apple's TV device also delivers Netflix.

Netflix itself, by the way, is a very interesting story. Having forced Blockbuster into bankruptcy with a superior business model, it has become a darling of the stock market. Yet Netflix faces formidable competition not only from Apple, but from Wal-Mart, which has announced its own video streaming business, and from Google, not to mention the cable providers like Comcast.

Despite all these formidable competitors, or perhaps because of them, you might think that there are scenarios in which Netflix itself could become an attractive acquisition candidate for Apple, particularly with its growing subscriber base of 20 million families. But Apple's iTunes database includes 200 million accounts, so the real challenge for Apple is not to expand its number of accounts by 10% through an acquisition, but to get a larger portion of the 200 million to become subscription customers rather than transaction-based customers.

What Apple needs, in other words, is its own entertainment subscription service. Perhaps it gets one by developing it, or perhaps by buying Netflix or another competitor.

- Providing content – news, movies, music – to iPads on a subscription basis could also become an attractive market as the number of iPad users increases beyond the 15 million sold to date.
- The company is also obliged to look for new device markets with significant growth potential. Perhaps Apple has another huge new product in the wings, but whether it has the next big thing or not, it could make a lot of sense to go after the commodity smart phone market by making a smaller iPhone at a lower price that can reach more customers around the world as an entry level device.
- Apple will also certainly continue to make iTunes and the App stores as attractive as possible for content makers to sell their creations.
- And lastly, Apple will look for markets where the company can act as a gateway between its device users and the providers and advertisers who want to reach them, which means that Apple will attempt to break through in the emerging mobile advertising market. Implementing expanded advertising capabilities was the intent behind Apple's acquisition of Quattro Wireless in early 2010, and iOS version 4, released last summer, provided more mobile advertising tools than previous versions.

Mac OS growth opportunity

- Apple will also look for enterprise markets where it can leverage its customer loyalty to capture new customer segments. This suggests that a renewed effort in the enterprise market to make the Mac platform a solid choice for corporate IT departments is in the offing. By providing unparalleled tools to link phones, pads, and corporate IT systems with the cloud, the company could conceivably expand its market share in the PC market and grow its Macintosh revenues.

A modest example of this occurred recently when the FAA approved iPads for use by some commercial pilots for their flight charts, enabling them to replace the old paper ones. If Apple succeeds market by market, then gradually the corporate IT departments will be surrounded, but it will happen only if the security tools are impeccable.

But speaking of security, a recent survey by Frost and Sullivan found that 80% of smart phone users are accessing corporate databases through their phones, naturally enough, but that the phones are woefully lacking in security features, thereby exposing the corporate data centers to attack by hackers. Whichever smart phone makers address these gaping hole the first, and the best, will gain considerable traction in the market.

Will all six of these efforts transpire? Probably not – the world is too complex to assume that they will. And this is an outsider's view, compiled from publicly available materials; those on the inside naturally have a much different view of this may all transpire.

And will there be other initiatives that I haven't mentioned? Of course – Apple's notorious and tantalizing secrecy only inspires the imagination to consider what might be as yet unrevealed.

But the purpose of this exercise has not been so much to predict, as it is has been to think about the market ecosystem in which Apple competes, and to explore some of the markets and possibilities that could enable the company to sustain its meteoric growth rate and maintain its lofty market cap.

Overall, Apple remains one of the most interesting of all high tech companies, and hopefully Jobs will regain his health and continue to exercise his unique form of creative leadership to bring more of the new, unexpected, useful, and delightful products, services, and business models that have characterized Apple's first 35 years.

By Langdon Morris

About the author



Langdon Morris is a co-founder of [InnovationLabs LLC](#), one of the world's leading innovation consultancies.



Langdon is also a Contributing Editor and Writer of *Innovation Management*, Associate Editor of the *International Journal of Innovation Science*, a member of the Scientific Committee of *Business Digest*, Paris, and Editor of the Aerospace Technology Working Group Innovation Series. He is author, co-author, or editor of eight books on innovation and strategy, and a frequent speaker at innovation conferences worldwide. He has lectured at universities on 4 continents.